

ORDER NO. 4757

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;
Tony Hammond, Vice Chairman;
Mark Acton; and
Nanci E. Langley

Periodic Reporting
(Proposal Four)

Docket No. RM2018-7

ORDER ON ANALYTICAL PRINCIPLES USED IN PERIODIC REPORTING
(PROPOSAL FOUR)

(Issued August 13, 2018)

I. INTRODUCTION

On June 25, 2018, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11, requesting that the Commission initiate a rulemaking proceeding to consider changes to accepted analytical principles relating to periodic reports.¹ The Petition identifies the proposed changes filed in this docket as Proposal Four, which would change the costing methodology for assigning costs related to debit card transactions (Debit Card Costs) in the component named “Retail Credit Card Fees (Component No. 126) in Cost Segment 13. Petition, Proposal Four at 1. Debit Card Costs are the fees the Postal Service pays to debit card issuers when Postal Service customers pay for a

¹ Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), June 25, 2018 (Petition).

product or service using a debit card.² For the reasons discussed below, the Commission approves Proposal Four.

II. PROCEDURAL HISTORY

On June 28, 2018, the Commission issued a notice initiating this proceeding, providing for the submission of comments, and appointing a Public Representative.³ Chairman's Information Request No. 1 was issued on July 13, 2018, with responses due on July 20, 2018.⁴ The Public Representative moved to extend the comment deadline to July 25, 2018, to allow adequate time for additional analysis of the Postal Service's response to CHIR No. 1, which the Commission granted.⁵

The Postal Service responded to CHIR No. 1 on July 20, 2018.⁶ The Public Representative filed comments on July 25, 2018.⁷ No other comments were received.

III. CURRENT METHODOLOGY

In Docket No. RM2015-4, the Commission approved the current methodology for assigning costs related to credit and debit card transactions.⁸ The current methodology treats these costs as fully volume variable and assigns them to products in the same

² One type of fee that may be incurred when using a debit card is an interchange fee, which is the largest categorical contributor to total debit card processing fees for a transaction. *Id.* at 5. A merchant pays an interchange fee to the debit card issuer whenever a customer makes a purchase using a debit card. See 12 C.F.R. § 235.2(j) (defining "interchange transaction fee" as "any fee established, charged, or received by a payment card network and paid by a merchant or an acquirer for the purpose of compensating an issuer for its involvement in an electronic debit transaction."). The debit card fees referred to in the Petition and this Order are interchange fees.

³ Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Four), June 28, 2018 (Order No. 4685).

⁴ Chairman's Information Request No. 1, July 13, 2018 (CHIR No. 1).

⁵ Public Representative Motion for Extension of Comment Deadline, July 19, 2018; Order Granting Motion to Extend Comment Deadline, July 20, 2018 (Order No. 4722).

⁶ Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 1, July 20, 2018 (Responses to CHIR No. 1).

⁷ Public Representative Comments, July 25, 2018 (PR Comments).

⁸ Petition, Proposal Four at 1; see Docket No. RM2015-4, Order Approving Analytical Principle Used in Periodic Reporting (Proposal Eleven), February 9, 2015 (Order No. 2350).

proportions as the Postal Service revenue received from aggregate credit and debit card transactions. Petition, Proposal Four at 1.

When preparing the FY 2017 Annual Compliance Report (ACR), the Postal Service explains that it identified two flaws in the current methodology. *Id.* First, the current methodology uses the total amount of both credit and debit card fees when calculating distribution factors. *Id.* This assumes that transactions made with debit and credit cards are similar, which is not true for every product. *Id.* For example, Priority Mail generates more revenue from credit card purchases than debit cards. *Id.* Conversely, Money Orders cannot be purchased using credit cards. *Id.* The Postal Service asserts that when calculating a distribution key, the card type (debit or credit) becomes more important because total credit card fees are almost four times greater than total debit card fees. *Id.* Because of this incorrect assumption, the Postal Service asserts that the current methodology misallocates costs related to debit and credit card transactions, especially for products that are more heavily purchased by one card type. *Id.*

The second flaw in the current methodology identified by the Postal Service is that the distribution factors do not fully align with actual expenses incurred from the usage of debit and credit cards. *Id.* at 2. For example, for Money Order transactions, the Postal Service charges the customer the face value of the Money Order plus a Special Services fee. *Id.* When calculating the Money Order share of total “revenue” for distribution purposes, the current methodology only considers the Special Services fee the Postal Service charges the customer. *Id.* The Postal Service asserts that this methodology is erroneous because the amount the Postal Service pays to the debit card provider is based on the entire transaction amount, including the face value of the Money Order, rather than just the Special Services fee charged. *Id.*

To address these two flaws in the current methodology, the Postal Service made two corrections to Library Reference USPS-FY17-32, which was filed with the FY 2017

ACR.⁹ First, the Postal Service separated credit and debit card fees to develop different sets of distribution factors for each card type. Petition, Proposal Four at 2. Second, the set of distribution factors for debit cards used the aggregate face value of Money Orders purchased with debit cards in conjunction with the revenue from all other products. *Id.*

In a supplemental Chairman's Information Request response, the Postal Service proposed a model attempting to account for the recognized major components of debit card fees.¹⁰ In the FY 2017 Annual Compliance Determination (ACD), the Commission stated that the proposed model was not an approved methodology for attributing Debit Card Costs.¹¹ It directed the Postal Service to continue investigating issues related to Debit Card Cost attribution and update the Commission on its progress and any potential corresponding methodological changes within 90 days after the ACD was issued. FY 2017 ACD at 64. The Postal Service asserts that Proposal Four is a result of this investigation. Petition, Proposal Four at 3.

IV. PROPOSAL FOUR

Description. Proposal Four would change the methodology for allocating Debit Card Costs by disaggregating total Debit Card Costs into two cost pools: Transactions and Proceeds. *Id.* The Transactions cost pool would account for Debit Card Costs for regulated transactions, which have limits on debit card fee amounts based on Federal Reserve regulations. *Id.* at 3, 5. Unregulated transactions do not have these limits. *Id.* at 5.

Debit card fees generally have two components: a fixed fee per transaction (regardless of transaction amount) and a variable fee that changes based on the

⁹ *Id.*; see Docket No. ACR2017, Library Reference USPS-FY17-32, December 29, 2017.

¹⁰ *Id.* at 2-3; see Docket No. ACR2017, Supplemental Response of the United States Postal Service to Question 1.b of Chairman's Information Request No. 2, February 23, 2018 (Docket No. ACR2017 Response to CHIR No. 2, question 1.b).

¹¹ Docket No. ACR2017, Annual Compliance Determination, March 29, 2018, at 64 (FY 2017 ACD). The Commission's rules require the Postal Service to use only accepted analytical principles in its annual periodic reports to the Commission, including the ACR. 39 C.F.R. § 3050.10.

transaction amount. Docket No. ACR2017 Response to CHIR No. 2, question 1.b. For regulated transactions, the Federal Reserve limits debit card fees to 22 cents per transaction (fixed fee) plus 0.05 percent of the transaction (variable fee).¹² Proposal Four would account for the debit card fixed fees in the Transactions cost pool for regulated transactions. *Id.* The Proceeds cost pool would account for the debit card variable fees along with other fees, including fees for unregulated debit card transactions. *Id.*

To calculate the amount of Debit Card Costs allocated to the Transactions cost pool, the Postal Service would first determine the number of regulated debit card transactions. *Id.* at 3. This is the total number of debit card transactions multiplied by the proportion of regulated transactions. The number of regulated transactions would then be multiplied by the approximate fixed per-transaction fee to calculate the amount of Debit Card Costs allocated to the Transactions cost pool. *Id.* at 3-4. The remaining amount would be allocated to the Proceeds cost pool. *Id.* at 4.

For example, in FY 2017, total Debit Card Costs were approximately \$58.6 million. *Id.* at 3. Proposal Four would have disaggregated these costs between the Transactions cost pool and Proceeds cost pool. There were approximately 150 million debit card transactions, 65 percent of which were regulated. *Id.* at 3-4. The approximate fixed per-transaction fee was 22 cents. *Id.* at 4. Thus, the Transactions cost pool would have equaled approximately \$21.3 million (150 million total debit card transactions x 65 percent regulated transactions x 22 cents per-transaction cost). *Id.* The remaining amount of \$37.3 million (\$58.6 million - \$21.3 million) would have been allocated to the Proceeds cost pool. *Id.*

Under Proposal Four, Debit Card Costs in the Transactions cost pool would be assigned to products proportionally based on the number of tenders captured from the Retail Data Mart. *Id.* Debit Card Costs in the Proceeds cost pool would be assigned to products in proportion to the total revenue received from debit cards, which is the same

¹² Petition, Proposal Four at 5. The 22 cent fixed per-transaction cost includes one cent for fraud protection costs. *Id.*

distribution key used under the current methodology. *Id.* The final Debit Card Costs assigned to each product would be the sum total of the respective amounts from each cost pool. *Id.*

The Postal Service states that Proposal Four reflects the proposed model presented in Docket No. ACR2017, but differs by distinguishing between regulated and unregulated transactions. *Id.* By contrast, the model proposed in Docket No. ACR2017 assumed that all of the debit card transactions were regulated. *Id.*

Rationale. The Postal Service asserts that Proposal Four would help address a flaw in the current methodology. *Id.* at 6. The current methodology assigns all Debit Card Costs to products in the same proportions as total revenue received from debit cards. *Id.* at 1. However, this methodology ignores the fixed “per-transaction” component of Debit Card Costs.¹³ The current methodology would be appropriate if all products had the same average revenue per transaction. Petition, Proposal Four at 6. Because they do not, products with below average revenues per transaction are assigned less than their appropriate share of the Debit Card Costs related to the fixed fee. *Id.* Conversely, products with above average revenues per transaction are assigned more than their share of these costs. *Id.*

For example, the average revenue per transaction for Money Orders is substantially higher than those of other products. *Id.* at 7. The Postal Service asserts that the current methodology overstated the Debit Card Costs assigned to Money Orders in FY 2017. *Id.* at 6-7. The Postal Service points out that applying Proposal Four would have properly distinguished between the fixed per-transaction and residual components for regulated transactions, which would have resulted in a more accurate assignment of Debit Card Costs to Money Orders. *Id.* at 7. The Transactions cost pool would account for the fixed per-transaction component of Debit Card Costs. *See id.* at 4. The Postal Service concludes that adopting Proposal Four would improve the

¹³ *Id.* at 6. The “per-transaction” component appears to refer to fixed debit card fees, which are the same for each transaction regardless of the transaction amount. *See* Docket No. ACR2017 Response to CHIR No. 2, question 1.b.

accuracy of its costing methods by more closely aligning with the way debit card fees are incurred. *Id.*

Impact. The Petition includes a table illustrating the cost impacts of Proposal Four. *Id.* at 7-8. This table compares the Debit Card Costs distribution as presented in the FY 2017 ACR with the distributions that would have resulted if Proposal Four's methodology had been used. *Id.* at 7. The Postal Service explains that the most significant change to the cost coverages filed with the FY 2017 ACR would be to Money Orders, which would have experienced an increase in cost coverage under Proposal Four from 97 percent to approximately 107 percent. On a unit cost basis, the impact on all other products "would be either trivial or, in most instances, entirely immaterial." *Id.* at 7-8. Institutional costs would have increased by \$1,020,267.¹⁴ The Postal Service provides further details in workpapers filed with the Petition.¹⁵

V. CHAIRMAN'S INFORMATION REQUEST

CHIR No. 1 asked the Postal Service to explain how it determines the number of debit card transactions and distinguishes between regulated and unregulated ones. CHIR No. 1, question 1. CHIR No. 1 also asked the Postal Service to explain how it calculates the percentage of regulated transactions in a fiscal year. *Id.* question 2. The Postal Service responds that when a customer uses a debit card, a request is sent to the Postal Service's card processor, which acts as an intermediary between the Postal Service and the card issuer. *Id.* question 1. It states that the size of the assets of the card issuer determines whether its transactions are regulated or unregulated. *Id.* The card processor receives and records information about debit card transactions and provides a report detailing the total number of debit card transactions, transaction amounts, and transaction fees incurred by card network and transaction type (regulated

¹⁴ *Id.* at 8. The Postal Service confirmed that the "Other Costs" category on the table refers to institutional costs. Responses to CHIR No. 1, question 3.a.

¹⁵ See Petition, Excel file "Prop.4.Debit.Card.Attachment.xlsx."

or unregulated). *Id.* The total number of regulated and unregulated transactions is calculated as the sum of regulated and unregulated transactions by network. *Id.*

To calculate the percentage of regulated transactions, Proposal Four divides the number of regulated transactions by the total number of transactions. *Id.* question 2. This percentage is then applied to calculate the Transactions cost pool amount as described above.

CHIR No. 1 also asked for information about Proposal Four's impact on institutional costs ("Other Costs"), as well as how the Postal Service distinguishes between transactions associated with postal versus non-postal products. *Id.* questions 3.a. and b.i. Costs related to debit and credit card transactions for postal products are fully volume variable, while costs associated with non-postal products are treated as institutional.¹⁶ The Postal Service confirmed that the total increase in institutional costs under Proposal Four would only include costs associated with non-postal products. Responses to CHIR No. 1, questions 3.a. and 3.b.i. The Postal Service explains that applying Proposal Four would increase institutional costs because non-postal products tend to have a lower unit revenue than average. *Id.* question 3.b.ii. It asserts that the methodology applied in Docket No. ACR2017 underdistributed Debit Card Costs to products with relatively smaller average transaction amounts. *Id.* Because Proposal Four would account for both fixed per-transaction costs and revenue, these products are assigned more Debit Card Costs than they were previously. *Id.*

CHIR No. 1 asked how the Postal Service distinguishes between transactions associated with postal versus non-postal products. The Postal Service explains that this process occurs at the channel level where the cards are accepted by the Postal Service. *Id.* Credit and debit card transaction amounts are available and distinguishable at the retail channel level because it provides payment type information on all products sold. *Id.* Although the vending channel does not distinguish by card type, the card processor provides a summary report listing the number of debit and

¹⁶ Rule 39 C.F.R. Section 3050.60(f) Report for FY 2017 (Summary Descriptions), July 2, 2018, file "CS13-17.docx," at 13-9.

credit card transactions and transaction amounts from this channel. *Id.* Proposal Four applies the proportions of debit versus credit card transactions to the total number of transactions and transaction amounts, respectively, to distinguish card type. *Id.* For all channels, the Postal Service uses product names to distinguish between postal and non-postal transactions. *Id.*

VI. COMMENTS

The Public Representative supports Proposal Four and recommends its approval. PR Comments at 4. She asserts that separating cost pools and distribution factors are improvements over the method used in prior ACRs, which assigned all costs based on the revenue received. *Id.* at 3. She comments that the Postal Service's method of obtaining and calculating the numbers and percentages of regulated and unregulated transactions appears reasonable and is an improvement from the methodology used in Docket No. ACR2017, which did not account for the differences between regulated and unregulated transactions. *Id.* at 3-4. She notes that the cost impacts of Proposal Four appear minimal and that Proposal Four would result in a more accurate calculation of Debit Card Costs assigned to Money Orders by distinguishing between the fixed per-transaction and residual (variable) components for regulated transactions. *Id.* at 4.

VII. COMMISSION ANALYSIS

The Commission may approve a proposal to change an accepted analytical principle if it finds that the proposal will "improve the quality, accuracy, or completeness of the data or analysis of data contained in the Postal Service's annual periodic reports to the Commission." 39 C.F.R. § 3035.11(a). The Commission has reviewed the Petition, supporting documents, the Responses to CHIR No. 1, and the Public Representative's comments. Based on this review, the Commission approves Proposal Four because the methodological change is an improvement over the current method of determining attributable Debit Card Costs.

Proposal Four would develop different sets of distribution keys for regulated debit transaction fees. Petition, Proposal Four at 1-2. This change represents an improvement over the current use of a single aggregate distribution factor because it provides a more accurate distribution of debit card fees to the products. Disaggregating Debit Card Costs into two cost pools improves the accuracy of Debit Card Cost data by properly distinguishing between regulated and unregulated transactions, which better reflects how debit card fees are incurred. *Id.* at 3-5.

VIII. ORDERING PARAGRAPH

It is ordered:

For purposes of periodic reporting, the Commission approves the changes in accepted analytical principles proposed by the Postal Service in Proposal Four.

By the Commission.

Stacy L. Ruble
Secretary